RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

POST OFFICE BOX 1759, LA JOLLA, CALIFORNIA 92038

26 LETTERS PER YEAR • $225 ANNUALLY

Sept. 7, 1988 **LETTER 999**

Aug. 26 DJIA 2017.43; PTI 2726; A-D Ratio -11.66
Sept. 1 DJIA 2002.31; PTI 2722; A-D Ratio -11.76
Current Dow Yield: 3.83%; Dow P/E: 11.8
Dow 200-day MA: 2012; DowPow: 644
Percentage of undervalued blue-chip stocks: 20%

MONEY: Not everyone's aware of it, but there's an international interest rate war going on. Here in the US the Fed (which has been worried about inflation) has already raised the bank discount rate twice (the latest increase from 6% to 6.5%). The boosts in the discount rate have strengthened the dollar (higher rates are obviously attractive to dollar buyers and holder).

Since high rates attract money, our trading partners have been raising their own rates. They've done so (1) because they want to stifle inflation in their own countries, and (2) because they don't want to see carloads of "hot money" leave their shores in search of higher rates.

But high interest rates mean pressure on business and a squeeze on equities. On August 24 the British raised their bank rate a full 1% to a whopping 12%. Rates in Japan, Germany Switzerland, Austria, Netherlands, and Canada have also been raised. Where will it all end? Obviously, nobody knows.

THE MARKET: How has the bear been doing in 1988? He's been doing quite well, by my reckoning. From the standpoint of the stock market, the most important event of the year, so far, is that the advance-decline ratio topped out back on March 17 (see page 2 chart). Thus, March 17 marks the peak in 1988 for the majority of stocks on the NYSE.

Despite the March 17 peak in the A-D ratio, the major stock averages continued to climb. July marked the peak. The Dow hit its 1988 high on July 5 at a value of 2158.61. Following the July peak the Dow (and all the major averages) joined the A-D ratio on the downside.

Two weeks ago the A-D ratio broke decisively under its May low (see page 2 chart). The comparable May low for the Dow is 1941.48. But the Dow halted its decline on August 23 at 1989.33, well above its May low. Thus the Dow did not confirm the weak action of the A-D ratio. The action and inter-action of the Dow and the A-D ratio during March through August tells us a number of things.

(1) In breaking below the May low, the A-D ratio wiped out all its gains of 1988. This tells us that anyone who bought an assorted portfolio of stocks during 1988 is now "under water."

(2) In breaking its May low the A-D ratio sets up the March 17, 1988 high as a major peak for the majority of stocks on the NYSE. The odds on that peak being bettered anytime during the rest of this bear market are slim, very slim.

(3) The break below the May low by the A-D ratio suggests that the July 5 Dow high of 2158.61 will probably stand as the high for the Dow for 1988 and beyond.

(4) As stated above, the Dow failed to confirm the A-D ratio in that the Dow refused to follow the A-D through its May low. This non-confirmation sets up a rally situation. The rally is now in progress. So far, the rally has been singularly unimpressive, but at any rate there should be a rally. Following the rally, I expect the bear to take over again, and I expect the Dow, the A-D ratio, and the majority of NYSE stocks to head south again.

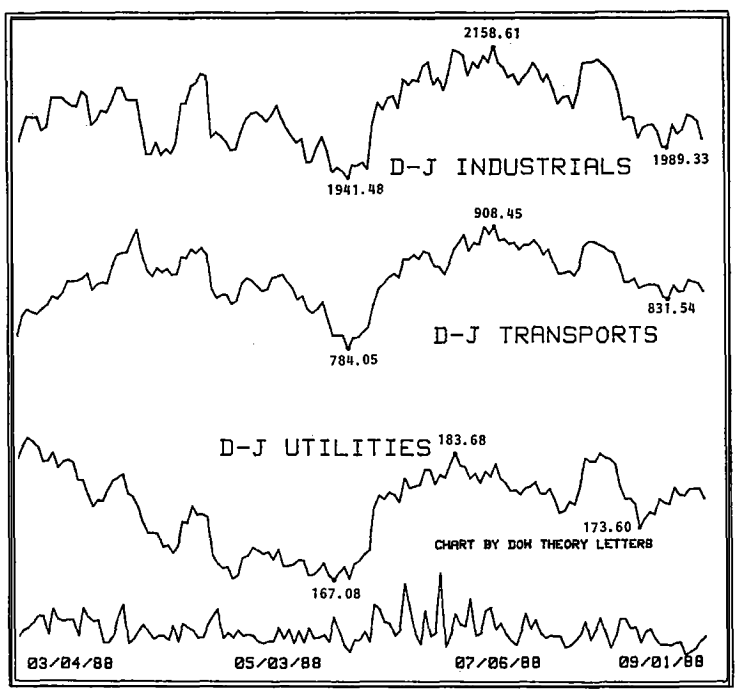
I continue to hear analysts talk about "what is needed to move the market higher." They talk about durable goods orders, the leading indicators, the trend of interest rates, the abilities (or lack thereof) of the presidential candidates, inflation, deflation, auto sales, on and on. As if any or all of these could reverse the major trend of the market.

One of the basic tenets of Dow Theory states that "the primary trend is not subject to manipulation." In other words, once the primary trend turns bullish or bearish, that trend will continue until the best (in a bull market) or worst (in a bear market) is fully expressed in the price structure.

"Ah, but what if the bull market did not top out in 1987?" I am asked. "What if the bull market is still alive and October was just an extraordinary mistake?"

It wasn't just October, I explain. October was the result of a whole year of distribution. Consider this: The Utility Average topped out on January 22, 1987. The A-D ratio topped out on March 25, 1987. The D-J Transportations topped out on August 14. The D-J Industrial Average topped out on August 25. Furthermore, the Dow topped out while spiking up in a steep parabolic curve -- accompanied by the almost universal opinion that "3600 on the Dow" was guaranteed.

The dream of 3600 was not to be. A Dow Theory bear signal was given on October 15. And on October 19, in what I termed "the greatest trend reversal action in Wall Street history," the market crashed.



There, do you still call October 19 a one-day accident? Most analysts are focused only on the October 19 crash. They accept October 19 as a single, isolated event -- and a "mistake" at that. I see October 19 as the logical resolution of a market that was so overvalued, so technically weak, so ready to drop that anything other than a crash would have been anti-climactic. In fact, I wrote before the crash that 50 years from now historians will look upon the July-August 1987 situation as a picture-book -perfect market top.

So I'm satisfied that August 1987 marked the end of the great 1974-87 bull market. By the same token, I'm convinced that, in due time, this bear market will run its course. The end of that course will be great values on Wall Street. "Great values" is a polite way of saying bargain stocks. Bargain stocks can only come about via (1) a major rise in earnings which occurs during the course of a bull market or (2) a great drop in prices which occurs during the course of a primary bear market.

On August 25, 1988 my Primary Trend Index (PTI) came down to touch exactly on its 89-day moving average (MA). Last week the PTI rallied up off its MA. The PTI just doesn't want to break down -- yet. For the PTI to turn bearish, I require it to fall decisively below its 89-day MA and remain there. That hasn't happened yet. It's close, but not there.

In the meantime, DowPow, my proprietary indicator of the Dow adjusted for the A-D ratio, broke to a low of 621 on August 23. Thus, DowPow remains weak as it flounders about in the lower area of its ten-month trading range. Ever since the lows of last October and December, DowPow has been steadfast in telling us that there has been no oomph, no power, in this post-crash correction. When DowPow finally breaks below its December low I would expect the second phase of the bear market to begin.

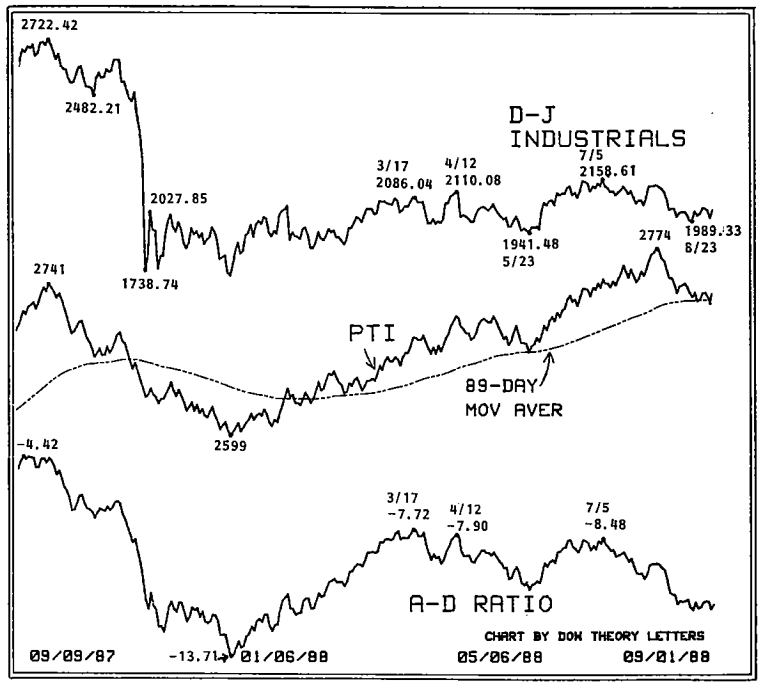
Note: I just had a long conversation with my old pal, Harry Schultz in Monaco. Among other things, Harry told me that his HSL International Index (made up of stock indices of all the major nations) gave a sell signal on August 28, its first sell signal in years (the signal came out of a head and shoulders top). So let's watch the foreign indices carefully. Remember primary trends (bull or bear) are always international in scope.

Harry made another observation. He said nobody is using the phrase "primary bear market" They're totally avoiding the whole concept. Instead, they're just complain about "dull markets" and "electronic trading." Avoiding the truth, we both noted, doesn't negate it.

I've discussed the Japanese market in detail in past Letters, warning of the ominous top being formed in the Nikkei. On September 1 the Nikkei plunged over 400 points to close below 27,000. As I see it, this action completes a major top in the Nikkei and constitutes an important "sell signal" for Japanese stocks.

INVESTMENT POSITION: I spoke last week at the San Francisco ISI seminar, and I told the audience that just as in August 1987 (in front of the same group) I had emphasized that the market was at a MAJOR TOP, this time I was emphasizing a single word, PATIENCE.

At this juncture the bear is trying to wear us out. The bear is thinking, "Keep the market in a tedious trading range long enough, rally it a bit here and there, and soon people will start nibbling at stocks again." People like action, whether it's in Las Vegas, Atlantic City, or on Wall Street. The bear knows this only too well. And that's what I want to warn subscribers about. This bear market is now testing our intelligence, our understanding of markets, our instincts, and, above all, our patience.



I wrote all last year (before the crash) that the operative word for the late 1980s and beyond was going to be INCOME. I said that the US standard of living was sliding, and that the way you stave off a declining standard of living is with income. Consciously or unconsciously, Americans seem to sense that -- witness the current intense interest in CDs, T-bills, notes, and bonds (and by the way, the muni contract is now within a point or so of its high for the year).

So, the three operative words for this bear market so far are MAJOR TOP, INCOME, and PATIENCE. And oh yes, the bear is still ruler of the box.

Question: Russell, what do you think about the possibility of inflation in the period ahead?

Answer: A lot of people are talking about "the coming inflation," but I'm skeptical. Let's look at a few of the key industrial commodities, commodities that almost always give hints of coming inflation.

Cotton has plunged from an '87 high of over 80 cents a pound to a recent 52 cents. Copper hit its high of $1.27 a pound in January -- since then it has come down to the 0.86-1.00 range. Lumber was $215 a bed foot in late 1987; it is now in the $172 range. Crude oil is down from an '87 high of $22 a barrel to the current price in the low 15s. And gold, well, I don't have to tell you that gold hasn't exactly taken off into the wild blue yonder. So inflation -- maybe it will roar in, but it isn't showing on my charts yet.

Question: What are the most reliable indicators for following the progress of a bull or bear market?

Answer: I use everything -- the Dow, S&P 500, NYSE Composite, all the major averages. One of the best indicators is the advance-decline ratio since this index tracks the advancing or declining tendencies of ALL the stocks on the NYSE. Yes, there is a mild downward bias to the A-D ratio (due to dividend payouts), but on a month to month basis this is not noticeable. During the course of a major bear market, the A-D ratio will head pretty

persistently down, and, of course, the opposite is true during a bull market.

And oh yes, my two proprietary indicators, the PTI and DowPow, are extremely valuable in tracking the course of a bull or bear market. Since the crash low, DowPow particularly has been a winner, and it has helped me sleep on many a night.

In terms that are easy to comprehend, the Wilshire 5000 Index is particularly handy. The Wilshire includes all NYSE and AMEX stocks plus all actively traded NASDAQ issues, and the Wilshire is expressed in dollars. Last year's bull market high for the Wilshire was $3.299 trillion. Last week the Wilshire was valued at $2.606 trillion. So based on last week's Wilshire, the bear market has lopped off a total of $623 billion in stock values. Any way you look at it, that's a lot of money.

Question: Recently, there's been all this talk about the 200-day moving average of the Dow turning up. What do you make of it?

Answer: The 200-day MA simply is a useful guidepost. It shows us what investors have been willing to pay (on average) for the Dow over the past 200 days. In a bull market the Dow tends to hold above its MA. The opposite is true during a bear market. As I've explained many times before, during powerful or extended secondary reactions in either a bull or a bear market, the Dow will move temporarily above or below its MA.

We saw an example of that a few weeks ago when the Dow pushed above its MA (and the MA turned up). Of course, the reason the MA turned up is that we were taking off the big crash figures of last October. However, as times goes by in this bear market, I think we will see that the Dow will tend to hold below its MA -- except, of course, during violent or extended secondary reactions.

Question: Up to this point, this has been a bear market for brokers and for Wall Street, but when do you think the bear market will spill over into the economy?

Answer: It's been just over a year since the primary trend of the stock market turned bearish. I would think that we should start to see trouble in the economy any time now -- or then again, the trouble might hold off until after the election. Actually, over the past week we have seen a few "bear market type" statistics emerging: (1) a 7% drop in durable goods orders, biggest drop in four years, (2) a big July drop of 0.8% in the leading indicators, (3) a July drop of 3.5% in orders for manufactured goods. A few more months of those kinds of statistics and the picture could turn grim.

Question: I've been reading Dow Theory Letters for amost a year. Russell, c'mon, do you ever recommend stocks to buy?

Answer: Yes, most definitely. I recommend stocks to buy when it's a bull market, at which time the odds are heavily on the side of the stockholder. I've recommended stocks to buy at all the major bottoms including the bottoms of 1957, 1974, 1982, and 1984. Furthermore, I add to my list of stocks to buy as long as the primary trend remains bullish.

Question: How do you think the election of Bush or Dukakis will effect the bear market?

Answer: Neither Dukakis nor Bush will make the slightest difference as far as turning the tide of the market. One or the other candidate may well affect HOW the bear market develops, but as far as ending the bear market -- forget it. Actually, nobody can even predict whether the bear would prefer Bush or Dukakis. Bush wants to retain a big military while at the same time keeping a lid on taxes. Meanwhile, the Duke never saw a missile program he didn't hate. Aside from the military, the Duke appears to want to spend everywhere else. Someone noted that if you say "Dukakis, Dukakis" fast, it sounds like "more taxes, more taxes."

In the end this bear market is going to continue in force until stocks are on a "great value" basis. How they get there may well be influenced by one or the other candidate. But no man alive can "end" a bear market or "start" a bull market -- although many have tried.

Roosevelt (a folk hero among liberals) came to the White House in 1932 at the bottom of the 1929-32 bear market. That was a time when Wall Street had nowhere to go but up (the Dow was 41 in July 1932). The New Dealers took credit for the turn, and Roosevelt stated with typical humility that "we planned it that way." But in 1937 (with Roosevelt still in the White House) the stock market fell in half and business entered a severe and violent recession-depression. Roosevelt didn't take credit for that one.

Question: Who would you say influences you most in your market thinking?

Answer: I read and listen to everybody, but there's only one source that influences me -- and that's the market itself. If there's one thing I've learned in this business it's that you have to think on your own, and you've got to stand on your own (which usually means you've got to stand alone). Over the years I've seen some of the best minds on Wall Street go completely haywire. And over the years I've seen some of the best minds in the advisory business be completely and totally wrong.

Wait, I'll revise what I said above. There are two people who influenced me tremendously, but they are both dead. The two are Robert Rhea, the great Dow Theorist of the 1930s, and George Schaefer, the brilliant Dow Theorist of the 1940s through 1974. These two men taught me how to read the market, how to think in the market, and how to stand alone against the consensus. Whatever success I've had in this business couldn't have come about without Rhea and Schaefer.

Question: Russell, you make quite a lot of the fact that the Dow has only been able to recoup 43% of its bear market (August '87 to October '87) losses. Why do you keep emphasizing this?

Answer: I emphasize it for two reasons. (1) Following a crash (and crashes are extremely rare), the price movement almost always recoups at least 50% of the losses. In 10 months of trying, the Dow only recouped 43% of its August-October losses, and that performance indicates weakness.

(2) Under Dow's 50% Principle, if the price movement cannot recoup at least 50% of the losses of an important preceding decline, the inference is that the movement which produced the losses is still in force. Applied to the current situation, because the Dow has been able to recoup only 43% of its losses, Dow's 50% Principle implies that in due time the Dow will come down and break below its October 19 crash lows.

Question: Where do you see interest rates going?

Answer: This is one of the toughest questions anyone can ask. But I'll give my opinion anyway. For the near to intermediate term, I think interest rates could go higher. As mentioned in the opening section of the Letter, there's a rate war going on, and interest rates around the world have been heading up. I see about a 30% chance of an interest spike somewhere ahead, a spike brought on by (1) competitive international rate boosts or (2) by a business collapse and an accompanying liquidity squeeze leading to a panic to borrow short-term money at any price (in other words, corporations would borrow just to stay in business).

BUT, following any near-term squeeze, I see a long period of declining rates, and I'm talking about a primary bull market in bonds. I believe that the great bear market in bonds that began in 1946 ended in 1981 with long T-bond rates at 15.25%. I don't think we're going to see long government rates at 15.25% again. We may see a temporary spike in rates, but it won't be as high as 15.25%.

DAMN: I guess you can say I've had it. In the space of one month (1) I was mugged by two men on the streets of San Francisco, (2) my pregnant daughter saw a man shot and killed in a drive-by shooting in front of her house in downtown San Diego, (3) and the last straw, a few nights ago another daughter called me at 5pm screaming hysterically into the phone because a man with a gun had just pushed his way into her apartment in Hollywood, pistol-whipped her, and took her money.

I don't know how many of you have been beaten up by thugs, and I don't know how many of you have picked up the phone to hear a hysterical daughter shrieking that she's banged up and bloody because some animal beat her with a pistol butt, but believe me it gets to you, it really does.

Three cities, three crimes, one family, and all within a month. I honestly think this nation is going a bit nuts, and I think drug users plus a collapse in this nation's morality are a large part of the problem. I believe we should either legalize drugs, let people who want to kill themselves on cigarettes, alcohol, cocaine, crack, heroine, pot, anything, let them do it. Let them take responsibility for their own lives while we take the profit out of dealing and pushing. Let the addicts buy the dope they want at reasonable prices (the way we already do for nicotine and alcohol freaks). But I don't want dopers and thugs killing me or my kids so they can get the cash to do their self-damage.

OR, I want to get the military into the fight. I believe we are now being INVADED by drug dealers as surely as we might be invaded by any other criminal nation. The local police, the DEA, and the FBI haven't been able to stop the avalanche of drugs coming into this country. It's an invasion. Thousands of pounds of cocaine are coming into the US weekly. When your nation's invaded, I believe the process is to call out the military.

NOTES & QUOTES: A number of worried subscribers sent me this ominous article from the Aug. 22 *Los Angeles Times*. According to the article, the majority of investment advisory letters are in a bad way. My guess is that it's because they missed the crash and consequently their subscribers are in a bad way or at least in a bad mood.

Investor Newsletters Declining Since Crash

NEW YORK (AP)—With the stock market going nowhere, the investment newsletter business is going under—at least for awhile.

Purveyors of tip sheets, investor hot lines and market-intelligence reports have suffered sharp declines in new subscriptions in the months since the October crash.

Several have put their businesses up for sale and others have stopped publishing because of cancellations and trouble in finding new customers, especially given the market's apathetic performance lately.

"Individual investors just aren't interested," said Dianne Chaykin, marketing director for Investment Information Services, a Chicago-based concern that publishes four newsletters. She said post-crash response rates to direct-mail solicitations have fallen by at least 50%.

A Few Faring Well

There have been other bad times for newsletters. Mark Hulbert, head of Hulbert Financial Digest, a Washington-based publication that tracks the performance of about 150 newsletters, said the last downturn was in 1984, before it was undoubtedly accounts for the current decimation in the advisory industry.

* *

I can report that (1) I didn't miss the crash, (2) I have been warning about the bear market ever since, and (3) subscriptions here are at a five-year high. The advisory business is a tough one, and today's guru-hero is often tomorrow's outcast (particularly if he lies about his pre-crash stance -- subscribers hate liars). There's an old adage in this business, and it goes, "Every advisor will be wrong on occasion, but the unforgiveable position is to stay wrong."

There's is one exception to that rule: You simply can't be bullish just before a market crash. Subscribers will be tolerant of most boo-boos, but they won't accept an overnight 25% or 50% wipe-out of their assets. That's asking a little too much. This

I just spoke to the people down at New Orleans who are running the big 15th anniversary New Orleans Blanchard seminar. You name him or her, they'll be speaking there -- from Henry Kissinger to (no kidding) Milton Berle, from Prechter to Ruff, from Dorfman to Dessauer, Browne, Fosback, Donoghue, Schabacker, Weinstein, and on and on. Why I'll even be speaking at New Orleans.

At any rate, the New Orleans people tell me that if you mention Richard Russell you can still come at the earlier (pre-August 1st) rates, which is (or was) $545 for a single and $745 for a couple. I didn't know I had that kind of clout, but there you are. Kidding aside, this will be a heck of a seminar, and even if you're angry at the stock, bond, or gold markets, it's worth going to the Big Easy for that spicy Cajun chow (call 1-800-322-6267 or 1-504-837-2902).

* *

Ed Hyman of *C.J Lawrence* (one of the nation's top economists) predicts bad news for the July trade figures. Noting that both Japan's and Korea's overall trade balances rose in July, Ed states that his model "suggests that the July Trade Gap will widen to $13.2 billion from June $12.5." Ed also has news on the deficit. He writes, "Social Security surplus is camouflaging the Federal deficit. Since December the Federal deficit has been basically unchanged at $153 billion. However, excluding the Social Security surplus, the deficit has deteriorated to $194 billion from $171 billion. This deterioration suggests that the Federal Government is 'spending' the Social Security surplus." Russell note: Nice, huh?

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Ouch Dept: The projected federal bailout of the S&L industry will cost a minimum of $50 billion (we taxpayers will pay) and very possibly as much as $100 billion. The big question is whether the S&L operators were running a scam, or whether the government was, in sweeping the whole ugly mess under the rug. . . . The Piper Alpha oil platform disaster (which killed 167 men in the North Sea in July) is developing into what could be the biggest insurance payout in history. The experts in London are saying the disaster will cost the insurance companies as much as $1.4 billion.

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Diamonds have been a girl's best friend over the last few years as their prices have been spurting. Diamonds have also be DeBeers' best friend (DeBeers controls roughly 90% of all diamond sales). DeBeers reports an 89% increase in their first-half '88 earnings and their dividend is up 67%. DeBeers also announces that the Russians are directing their "rough" (unpolished) diamond sales to the Central Selling Organization (this is the selling arm of DeBeers). The DeBeers diamond monopoly is undoubtedly the most successful cartel in the history of any business anywhere.

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Are athletes getting bigger? Get this: Ten of University of Southern California's current linemen (football, of course) weighed in at over 280 pounds and five weighed in at over 300 pounds. And they get bigger when they go to the NFL. . . . Here it is! *Pro Football Weekly*, the bible of football, has polled its writers and they come up with Cleveland as AFC champs, Giants as NFC champs, and Cleveland to win the Super Bowl.

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Items: Ford's hot new Thunderbirds and Cougars are expected to cut further into GM sales. . . . The newly designed Jaguar XJ6s are showing disappointing sales and Jaguar has been laying off workers (personally, I think Jaguar goofed its the new designs). . . . *Fortune* says the Mars candy family are the richest Americans, worth around $12.5 billion (in which case they now pass the Newhouse publishing people as the No. 1 US moneybags family).

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The Dems have shrewdly left the Quayle-baiting to the liberal press. Ed Rollins (Republican consultant who managed Reagan's 1984 race) states that in picking Quayle, Bush violated three basic principles: (1) Never pick anyone for VP who is untested, (2) If you select an unknown, do it early so the candidate can clear away any doubts before the convention and party officials have time to unite behind the ticket, (3) Select someone who can deliver a major state or help you with a large voter group. Says Rollins: The argument that Quayle can help with the baby-boomers "is a lot of

rot." Russell opinion: The press overdid it in their Quayle-baiting. I think there's a backlash now, and I think sympathy for Quayle is rising.

GOLD: I continue to receive letters and calls from subscribers asking where and how to buy gold. You can buy gold coins (Coronas, Krugerrands, Maple Leafs, Eagles) from your local coin dealer. Check the price quote against the daily London fix. If the Kruggies are more than 1% or 2% above the price of an ounce of gold, your dealer is getting greedy. When you buy, take possession of the coins, put them in your bank vault, and that's it. If you have no local dealer, call Benham Certified Metals at 1-800-447-4653 or James Blanchard Co. at 1-800-535-7633 or Silvertowne at 1-317-584-7481 or Auric United at 1-800-348-4653. Again, check comparative prices.

Many analysts (an increasing number of late) have been predicting an ultimate collapse for gold. The main arguments are (1) there's too much gold being produced in the world today, (2) gold hasn't responded at all to current inflation fears, (3) with interest rates currently high, it costs too much (in lost interest) to hold gold, (4) on the charts, gold appears to be in a distribution pattern.

None of these arguments have stopped me from buying my fixed dollar amount of gold at the first of each month. I've been writing about gold in each and every Letter since August 1960, but I would say that I am less interested in the trend of gold today than ever before. Note that I haven't been recommending gold shares, gold funds, gold certificates. I simply want my subscribers to own bullion gold coins. I want to be on a coin-accumulation program. From the standpoint of dollar-averaging, I don't care whether gold goes up 100 points or down 100 points. I just want to accumulate gold.

I feel that somewhere ahead (and the timing is impossible) gold is going to make a major move -- up. The move could begin slowly (as during the middle-1970s) or it could happen overnight. The rise could start from a price of 300 or from the current 425 -- I don't know, nor does anyone else.

If and when the world gets into real trouble, they're going to want to raise their central bank reserves. The easiest way to do that is to raise the price of gold. We have precedents for such action. It could happen again, and it could happen suddenly, overnight.

One item I want to discuss. Amid all the talk of too much gold being produced, it is informative to note the following: These statistics are from a recent *Salomon Bros.* study, and here we see the kind of international debt issuance coming out each quarter. To put it bluntly, the issuance of debt dwarfs the value of gold that is being mined today. And to me, it's always worthwhile to buy the scarcer item, which, of course, is gold.

International Debt Issuance, 1987-2Q 88 (U.S. Dollars in Billions[a])

	1987		1988	
	3Q	4Q	1Q	2Q
Totals	**$42.6**	**$28.7**	**$58.4**	**$59.6**
U.S. Dollar	20.7	8.0	17.1	20.6
Japanese Yen	1.4	5.6	5.5	6.9
Deutschemark	2.0	3.2	8.0	4.3
U.K. Sterling	2.5	2.8	7.2	8.2
Canadian Dollar	1.8	0.3	3.7	4.1
Australian Dollar	2.4	0.1	1.7	2.9
Other Currencies	11.8	8.7	15.2	12.6

LATE NOTES: The Dow has been spending the last few weeks bouncing above and below its 200-day moving average, which now stands at roughly 2012. At the same time, my PTI has been fluctuating above and below its 89-day moving average which now stands at 2726 (see page 2 chart). On September 1 the PTI dropped to 2722, but on the next day (Friday) the PTI bounced above the MA again.

Lacking anything better to do, the analysts and the market are pouncing on every economic statistic. On September 2 the unemployment figures were released, and unemployment was up a minor 0.3%. The bond market rallied strongly on the news ("hey, maybe the economy is finally slowing down") and the stock market lost no time in joining in.

At mid-morning an event occurred which amounted to another pin being stuck into the inflationary balloon. The price of crude oil (near-term contract) broke under 15 dollars a barrel. In harmony with the weakness in crude, gold immediately sank over four dollars an ounce.

All of this deflationary action was tantamount to heaven on earth for the bond market. The Treasury bonds rocketed up almost two points while the muni contract rose well over a point, the latter recording a new high for the year.

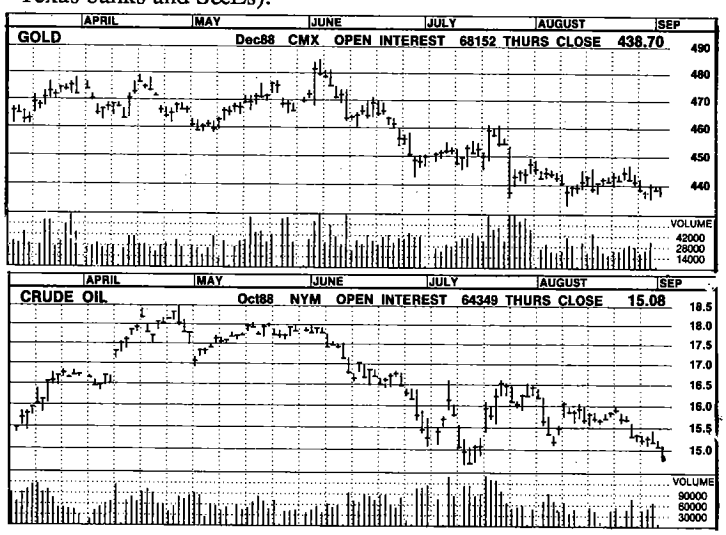
The stock market, long worried about inflation, was not immune to the weakness in oil and gold and the surging strength in bonds. Remember, the A-D ratio had already been in a five-month decline (March to August), while the Dow had lost 160 points since its July high. The market was therefore substantially oversold and ready to rally on its own. Furthermore, the Dow had refused to break with the A-D ratio below its May low, and this non-confirmation set up additional pressure for a rally. By mid-day the Dow was up over 40 points while breadth was putting in its strongest performance in weeks.

I've said this many times already, but I guess it's time to repeat it. This is going to be a long, tedious, difficult bear market. But remember this -- the bear is in no hurry, no hurry at all, so why should we be? Bonds are attractive, money market funds are attractive, and I find it no sacrifice to sit on the sidelines and collect the interest. In a major bear market, AA-rated muni bonds yielding 7.7% totally tax-free look a lot more attractive to me than an erratic Dow yielding a taxable 3.8%.

Furthermore, I consider munis even more attractive in light of the almost-certain boost in taxes which will come next year. The bond market, by the way, seems to sense this. The action of the munis during 1988 has been dramatically better than the action of either Treasury or corporate bonds.

If you like inflation, you're not going to fall in love with these two charts (charts courtesy of *Investor's Daily*). Here we see the December gold contract hanging just above the 435 level, and I mean hanging on.

The second chart shows the October crude oil contract, which on Friday, Sept. 2 broke down below 15. With a massive over-supply situation in crude, oil bears are talking about $10-oil by the first quarter of 1989. If so, our oil-producing states are going to have problems up to their eyeballs (and so will our government, which is currently in the expensive and painful process of "bailing out" the Texas banks and S&Ls).



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